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TAGS: EFIN EAID ECON ENRG PGOV JO
SUBJECT: DRAFT 2008 BUDGET EXPECTS HIGH INFLATION AND SLOWING GDP GROWTH

REFS:
A) AMMAN 4338
B) AMMAN 4207
C) AMMAN 3661
D) AMMAN 3557

¶1. (SBU) Summary: Jordan's 2008 budget now being prepared is expected to include raises for public sector employees and pensioners, and to exclude fuel subsidies, which have necessitated budget annexes in 2007. The draft budget assumes a slow-down in GDP growth to four percent in 2008 after three years of approximate six percent growth, and 10 percent inflation in 2008 because of high oil prices, elimination of the fuel subsidy, and the weak dollar, which will have a large negative impact on Jordanian families. Jordan has been working with a USAID-funded project to improve its budgeting processes. End Summary.

2008 Draft Budget Nearly Complete

¶2. (SBU) During a November 12 meeting, Dr. Ismail Zaghloul, Director General of the Finance Ministry's Budget Department, told EconOff that his department is finalizing the 2008 budget, which is due to the Cabinet by December 1. Once accepted, the Minister of Finance will submit the budget to the Parliament for approval. Zaghloul noted that Jordan's parliamentary elections on November 20 may result in a Cabinet reshuffling that could slightly affect the timing of the budget approval process.

2008 Budget Accounting for High Inflation

¶3. (SBU) Zaghloul said the 2008 budget has been difficult to prepare, in part because of high projected inflation around 10 percent in 2008. He said half of this inflation would come from rising oil prices, and the other half from Jordan's peg to the dollar at an official exchange rate of one Jordanian Dinar (JD) to USD 1.40. While Jordan's currency is tied to the dollar, the majority of its imports come from the Middle East and Europe. The falling dollar, and hence the falling dinar, is increasing the price of imports to Jordan. NOTE: Jordan has a preference for American-made products, but high transportation costs negate any benefits from purchasing goods in dollars. END NOTE. On November 8, the Department of Statistics (DOS) reported a 5.4 percent inflation rate for the first ten months of 2007, a rate slightly lower than the 2006 inflation rate.

¶4. (SBU) Due to the expected rise in inflation, Jordan is preparing for salary or payment increases for 550,000 public sector employees and pensioners. Zaghloul said that this would be the largest expenditure change in the 2008 budget. He said most ministries

would see their budgets grow with inflation, and he did not expect inordinately large increases in any ministry. He added that capital projects are expected to remain concentrated in three ministries: Public Works, Education, and Health.

No Fuel Subsidies; Inclusion of Social Safety Net
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¶5. (SBU) Zaghloul confirmed that the draft 2008 budget would not provide for fuel subsidies, which if continued, would cost Jordan USD 1.4 billion in 2008 (Refs A and D). He emphasized that ending fuel subsidies is a smart and difficult decision for Jordan, expected to be made no later than March. He said barley subsidies should also be lifted (Ref C), and expected this also to be decided in March. In separate conversations with EconOffs, Ministry of Industry and Trade Secretary General Montasser Oklah was skeptical, explaining that while subsidy programs should have ended years ago, Jordan was financially incapable of ending two popular programs at the same time and that doing so would result in "chaos." To minimize the impact of lifting the subsidies, however, the 2008 budget is planning increased safety net funding through the National Aid Fund, and for financial support to unemployed or underemployed citizens. NOTE: The National Aid Fund is an independent organization established to support needy families through aid and work opportunities. END NOTE.

Slowing GDP Growth and Exports

¶6. (SBU) Zaghloul predicted that GDP would grow four percent in ¶2008. He said Jordan's GDP grew 5.8 percent in the first six months of 2007, and is projected to grow six percent in 2007. He attributed the slowing in 2008 to inflation-driven higher production costs, and said the industrial and agricultural sectors will be

particularly hard hit. He said the industrial sector would be doubly hit by rising oil prices - since oil is a large component of their production cost structure - and by the weak dollar since a majority of raw materials are imported into Jordan.

¶7. (SBU) Zaghloul also feared that Jordan's industrial sector, which exports primarily to the Middle East, would further slip in its competitiveness because rival firms in nearby oil-producing countries often receive subsidized fuel. He said this could result in a sharp rise in Jordan's current account deficit in 2008. The Department of Statistics reported on November 12 that Jordan's trade deficit widened by 12.3 percent during the first nine months of ¶2007. The widening trade deficit has been a major factor in the deterioration of the current account, which moved from a surplus of USD 1.2 billion in 2003 to a deficit of USD 2.3 billion in 2005 and USD 2 billion in 2006.

Paris Club Debt Restructuring Short 900 Million Dollars
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¶8. (SBU) Commenting on the debt restructuring program approved by Paris Club members in October, Zaghloul said that if Jordan pays USD 1.9 billion for the buyback, it will save USD 1.26 billion in the coming 14 years in interest and principal. He estimated that Jordan had one billion USD in privatization proceeds available for debt buyback, but that all future privatizations would be small and would not cover the outstanding USD 900 million. He said Jordan hopes to fund the USD 900 million with international assistance, and said this aid would lift "a heavy burden on Jordan's budget." Finance Ministry Acting Assistant Secretary General Ezz Eldeen Kanakria said the deficit was a direct result of rising oil prices and Jordan's fuel subsidy program.

Impact on Jordanian Families

¶9. (SBU) Zaghloul was optimistic that some features of the budget, particularly the increase in public sector salaries and pensions and the increased safety net estimated at USD 420 million, would have a positive impact on about 65 percent of the population. He

cautioned, however, that these increases will only partially offset the predicted rise in inflation, and he expected a public outcry, particularly since oil prices are expected to have increased 400 percent in Jordan between June 2005 and February 2008. He added that lifting the barley and wheat subsidies would increase meat prices and the price of other foodstuffs. He said this inflation would hurt a population that already has a negative savings rate and relies heavily on real estate sales and remittances (Ref B).

Budget Process Reforms

¶10. (SBU) Jordan has been working closely with USAID to reform its budgeting process, and as a result, will begin working in 2008 with a three-year budget covering 2008-2010. Zaghloul praised USAID's help, and said that the three-year budget will allow for medium term expenditure planning, better prioritization of capital projects, and the ability to build a long-term plan to reduce the deficit. He added that Jordan has remained on a path of fiscal and monetary reform since the early 1990s, citing Jordan's graduation from its IMF programs, the removal of restrictions on foreign investment, and that Jordan will be the first Middle Eastern country to use results-oriented accounting.

¶11. (SBU) A USAID Fiscal Reform project representative said that the project was on-schedule and had benefited from strong Jordanian leadership including Zaghloul's. The representative said the project will provide Jordan with a new chart of account and an information system which links the charts of account between all of the ministries and the Ministry of Finance. NOTE: A chart of account is the tool used to classify, record, budget and report financial transactions. END NOTE. The representative said one reason for this extensive budget project is that Jordan is limited in its ability to grow revenues further because its taxes are as high as they can be, and thus this project focuses on government expenditures. He said that by changing to a results-oriented budget and by training the government on program evaluation, Jordan will be able to direct its expenditures to the most effective projects and ideally cut costs and limit corruption.

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